DRAKENSTEIN

MUNISIPALITEIT • MUNICIPALITY • U MASIPALA WASE

"A Place of Excellence"

# BORROWING POLICY

| DATE APPROVED / REVIEWED | COUNCIL MEETING DATE | DATE OF IMPLEMENTATION |
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# 1. DEFINITIONS

1.1 In this Policy, unless the context indicates otherwise –

1.1.1 ***"Act"*** means the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003);

1.1.2 ***''Authorised official''*** means an employee of the Municipality responsible for carrying out any duty or function, or exercising any power in terms of this policy and includes employees delegated to carry out or exercise such duties, functions or powers;

1.1.3. ***"Council"*** means the Municipal Council of the Municipality;

1.1.4. ***"CFO"*** means the Chief Financial Officer of the Municipality;

1.1.5. ***"Disclosure statement"*** means a statement issued or to be issued by the Municipality which intends to incur debt by issuing municipal debt instruments;

1.1.6. ***"Financing agreement"*** means any loan agreement, lease, instalment, purchase arrangement under which the Municipality undertakes to repay a long-term debt over a period of time;

1.1.7. ***"Juristic person"*** means a body of persons, a corporation, a partnership, or other legal entity that is recognized by law as the subject of rights and duties;

1.1.8. ***"Lender"*** means a juristic person who provides debt finance to the Municipality;

1.1.9. ***"Loan covenant*"** means a condition in an agreement relating to a loan or bond issue that requires the borrower to fulfil certain conditions or which forbids the borrower from undertaking certain actions, or which possibly restricts certain activities to circumstances when other conditions are met. Violation of a covenant may result in a default on the loan being declared, penalties being applied, or the loan being recalled;

1.1.10. ***"Long term debt"*** means debt repayable by the Municipality over a period exceeding one (1) year;

1.1.11. ***"Municipality"*** means the Drakenstein Municipality;

1.1.12. ***"Municipal debt"*** means –

(a) A monetary liability or obligation on a Municipality by –

(i) A financing agreement, note, debenture, bond or overdraft; and

(ii) The issuance of municipal debt instruments; and

(b) A contingent liability such as that created by guaranteeing a monetary liability or obligation of another.

1.1.13. ***"Security"*** means any mechanism intended to secure the interest of a lender or investor and includes any of the mechanisms mentioned;

1.1.14. ***"Short term debt"*** means debt that is repayable over a period not exceeding one (1) year;

1.1.15. ***"Sinking fund"*** means a fund established where provision is made to accumulate sufficient funds to repay the capital on a municipal bond issue at the end of the loan period as a lump sum which is termed a 'bullet' payment; and

1.1.16. ***"QBMR"*** means Quarterly Borrowing Monitoring Return.

## 2. PURPOSE

2.1 To establish a borrowing framework policy for the Municipality and set out the objectives, policies, statutory requirements and guidelines for the borrowing of funds.

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## 3. OBJECTIVES OF THE POLICY

3.1 Drakenstein Municipality's Borrowing Policy aims at gaining the lowest interest rate on any external borrowings, short-term as well as long-term, but still the credit exposure risk in mind. The effectiveness of this policy is to ensure that the cash management program make provision for the repayment of interest and redemption on the external borrowings.

3.2 It is the responsibility of council as a trustee of the community's revenue to ensure that the best repayment interest rates on external borrowings is obtained through a fair and transparent tender process and to ensure compliance with all Legislation and Council policy's governing borrowings of funds.

## 4. SCOPE

4.1 The primary goal in the borrowing of funds is to ensure that the funds are obtained at the lowest possible interest rates at minimum risk, within the parameters of authorised borrowings.

### *4.1.1 Risk Management*

The need to manage interest rate risk, credit risk exposure and to maintain debt within specified limits is the foremost objective of the borrowing policy. To attain this objective, diversification is required to ensure that the Chief Financial Officer prudently manages interest rate and credit risk exposure.

### *4.1.2 Cost of Borrowings*

The borrowings should be structured to obtain the lowest possible interest rate, on the most advantageous terms and conditions, taking cognisance of borrowing risk

constraints, infrastructure needs and the borrowing limits determined by Legislation.

### *4.1.3 Prudence*

Borrowings shall be made with care, skill, prudence and diligence.

## 5. ETHICS

5.1 In dealing with financial institutions, the following ethical principles must be adhered to –

(a) The chief Financial Officer shall not accede to any influence by or interference from councilors, borrowing institutions or any outsiders.

(b) Under no circumstances may inducements to borrow be accepted.

(c) The business ethics of any controlling body (Financial Services Board) of which Drakenstein Municipality is a member must be observed by such institution or body at all times.

## 6. PRINCIPLES

6.1 The guiding principles in Chapter 6 of the MFMA in terms of short-term and long-term debt must be adhered to in order to facilitate the administration of council's borrowings.

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## 7. DELEGATIONS OF AUTHORITY

7.1 The relevant Legislation in terms of which borrowing decisions are governed is the Local Government Municipal Finance Management Act, No 56 of 2003.

7.2 The Municipal Regulations on Debt Disclosure has been promulgated (Government Gazette no. 29966, 15 June 2007) and has been effective from 1 July 2007 for a municipality or municipal entity. Refer to Annexure A2, Municipal Finance Management Act: Municipal Regulations on Debt Disclosure.

7.3 Council is the only body that can approve external borrowing as a budget item. The Bid Adjudication Committee awards the tender to the successful bidder and thereafter Council will delegate to the Municipal Manager and the Chief Financial Officer of the Municipality to enter into a contract with the successful bidder and the signing thereof.

## 8. NOMINEE ACCOUNT

8.1 All monies disbursements as a result of the borrowing must be placed into the primary bank account of the municipality and this account must be reported to National and Provincial Treasury and the Auditor General in terms of section 9(a) and (b) of the MFMA.

## 9. REGISTERED FINANCIAL INSTITUTIONS

9.1 When borrowing needs to be done it should be required from the borrowing institutions to state weather they are registered in terms of the Bank Act of 1990 and / or any other applicable legislation.

# 10. GENERAL BORROWING PRACTICE

## 10.1 GENERAL

(a) Borrowings shall be done at an institution offering the most favorable repayment interest rates on the amount to be borrowed over a specific period.

(b) Institutions shall be advised that in submitting their tenders they must offer their best interest rates for the repayment of the interest and redemption on the borrowings. Council has the write to take on a loan in full or just part thereof.

(c) After submission of the tender no discussion or negotiation will be entered into until such time the tender is awarded to the successful bidder.

(d) Certificates of balances on the outstanding amounts on the loans must be acquired and the end of the financial year.

## 10.2 TYPES OF LOANS AND FINANCING

### *10.2.1 Annuity loans*

(a) Annuity loans are straight forward and uncomplicated. The loan amount, interest rate and repayment period offered by the Financial Institution are fixed. The calculation of the instalment payable on an annuity / fixed redemption basis is simple and straight forward. Normally with an annuity loan, the instalment of the loan will be repaid in equal six monthly instalments over the term of the loan. The capital portion of the instalment will increase over the duration of the loan, and conversely, the interest amount charged will decrease over the loan period.

(b) Where the interest rate offered by the Financial Institution is on a variable basis, an interest rate swap (IRS) should be taken out. An IRS agreement will need to be signed with the party agreeing to accept the variable rate and in turn, offer the fixed rate to the Municipality. An Interest Rate Swap Agreement must comply with the terms set out by the International Swap Dealers Association (ISDA). The fixing of debt repayments is an important consideration in meeting the financial requirements of the Municipality, that of annually producing a balanced budget. There are from time to time various options offered by Financial Institutions which need to be treated on their merits and which could invariably result in slightly lower interest rates being offered.

### *10.2.2 Bullet payment redemption*

(a) In this instance, the total capital is usually repaid at the end of the term and interest on the total amount borrowed is paid annually or semi-annually. The interest rate can be fixed and the interest payable is known for the duration of the loan. Cash has to be set aside to repay the capital at the end of the term.

(b) The lender could require security in the form of an investment (sinking fund).

### *10.2.3 Bonds*

(a) A Bond is an instrument used by Government and Parastatals such as Telkom, Eskom, Transnet, Corporates and Municipalities to raise loan capital on the open market. Bond holders have the right to interest, usually paid on a semi-annual basis, and the repayment of the capital amount reflected on the stock certificate held on maturity date.

(b) The coupon, maturity, principal value and market value are intrinsic features of a Bond. The most critical variable factor in determining Bond rates is the expected long term trend in inflation, in order to provide a return that equals

inflation plus a risk premium. The higher the risk attached to a borrower, the higher will be the risk premium investors will demand. During its tenure the Bond will trade on the Bond market at prevailing interest levels. Bond prices move inversely to movements in interest rates.

***10.2.4 Use of Internal Funds***

(a) The Municipality from time to time, will use certain of its surplus funds to fund its Capital Programme. The utilisation of surplus funds enables the Municipality to reduce its reliance on external debt financing, thereby allowing it to borrow only funds from external sources when favourable market conditions prevail.

(b) The use of internal funds impacts negatively on surplus cash for return of interest and should be within limits to reduce the impact on the Current Ratio ideally to be at a ratio of 1.5 to 1 and the Cost Coverage Ratio ideally to be between 1 to 3 months.

10.3 OTHER CONSIDERATIONS

(a) The Municipality has by the judicious use of surplus funds and external long term debt to implement its Integrated Development Plan, which has facilitated the much needed service delivery program.

(b) Factors to be considered when borrowing are –

(i) The type and extent of benefits to be obtained from the borrowing;

(ii) The length of time the benefits will be received;

(iii) The beneficiaries of the acquisition or development;

(iv) The impact of interest and redemption payments on both current and forecasted property tax and services revenue;

(v) The current and future capacity of the property tax base and rendering of services to pay for borrowings and the rate of growth of the property tax base and services;

(vi) Likely movements in interest rates for variable rate borrowings;

(vii) Other current and projected sources of funds;

(viii) Competing demands for funds; and

(ix) Timing of money market interest rate movements and the long term rates on the interest rate curve.

(c) The Municipality will, in general, seek to limit its dependence on borrowings in order to minimise future revenue committed to debt servicing and redemption charges. The Municipality may only borrow funds, in terms of the Municipal Finance Management Act, for the purpose of acquiring assets, improving facilities or infrastructure to provide service delivery.

(d) Drakenstein Municipality may incur long term debt only for the purpose of capital expenditure on infrastructure, property, plant or equipment to be used for the purpose of achieving the objects of Local Government as set out in section 152 of the Constitution.

(e) The use of external loans should be limited to financing infrastructure where a return can be realised from tariffs to service the debt. There must be clear long term benefits to the community as a whole where indirect revenue streams are evident.

(f) The current gearing ratio for external loans should not exceed the 50% mark (total outstanding debt ÷ total operating revenue less capital grants).

(g) However, if investment in infrastructure is needed to stimulate economic development with clear benefits for the community as a whole over the short and medium term, then the gearing ratio may exceed the 50% mark

provided that interest and redemption to service external loans shall not exceed 20% of total operating revenue less capital grants and conditional operating grants.

10.4 CONTROL AND MONITORING BORROWINGS

(a) A proper record must be kept and maintained of all the borrowings made, indicating at least the institution, borrowing amount, interest rate, start date, closing date, redemption amount, interest amount and the purpose for the borrowing.

(b) Repayment schedules received from the borrowing institutions must be checked to verify the correctness of the repayments. Repayment of interest and redemption must be done in time to avoid penalty interest.

10.5 REPORTING

(a) The Financial Officer shall in terms of section 71 of the MFMA report to National and Provincial Treasury on the state of the borrowings. This reporting must be done on a monthly and quarterly basis.

(b) A report on the stand of the borrowings must also be submitted to council. A report is drawn up marked “Appendix A “to be included in the Annual Financial Statements.

## 11. REFINANCING DEBT

11.1 Section 46 of the Municipal Finance Management Act provides that the Drakenstein Municipality may refinance existing long term debt, if such refinancing is in accordance with the framework as prescribed by the Municipal Finance Management Act, as follows –

(a) The Municipality may borrow money for the purpose of refinancing existing long term debt, provided the existing long term debt was lawfully incurred and the refinancing will not extend the term of the debt beyond the useful life of the infrastructure, property, plant or equipment for which the money was originally borrowed.

(b) Cognisance must be taken of any early repayment penalty clauses in the initial loan agreement, as part of the financial feasibility assessment. No loans will be prematurely redeemed unless there is a financial benefit to the Municipality.

## 12. DEBT REPAYMENT PERIOD

12.1 Whilst the period for which loan debt may be received will vary from time to time according to the needs of the various Lenders, presently the typical debt repayment period for loans is fifteen years, though not closely matching the underlying asset lives serviced by the loans.

12.2 Cognisance is taken of the useful lives of the underlying assets to be financed by the debt, and, moreover, careful consideration is taken of the interest rates on the interest yield curve. Should it be established that it is cost effective to borrow the funds on a shorter duration (as opposed to the life of the asset) as indicated by the interest yield curve, the loan will be negotiated to optimise the most favourable and cost effective benefit to the Municipality.

## 13. SECURITY

13.1 In terms of the Municipal Finance Management Act the Municipality may provide security for any of its debt obligations, including the giving of a lien, pledging, mortgaging or ceding an asset, or giving any other form of collateral. It may cede as security any category of revenue or rights of future revenue. Some Lenders

may require the Municipality to agree to restrictions on debt that the Municipality may incur in future until the secured debt is settled.

## 14. SHORT TERM DEBT

14.1 The Municipal Finance Management Act provides that the Municipality may incur short term debt only when necessary to bridge shortfalls within a financial year during which the debt is incurred, in expectation of specific and realistic anticipated income to be received within that financial year; or capital needs within a financial year, to be repaid from specific funds to be received from enforceable allocations or long term debt commitments.

14.2 The municipal council may approve an individual transaction or a credit facility for a line of credit or overdraft facility.

14.3 The Municipality must pay off short term debt within the same financial year and may not renew or refinance its short term debt if it will have the effect of extending the short term debt into a new financial year.

## 15. DISCLOSURE

15.1 The Municipality must, when interacting with a prospective Lender or when preparing documentation for consideration by a prospective Investor, disclose all relevant information that may be requested or that may be material to the decision of the prospective Lender or Investor. Reasonable care must be taken to ensure the accuracy of any information disclosed. Whilst this is a standard and acceptable business practice, it is also in compliance with section 49 of the Municipal Finance Management Act.

## 16. GUARANTEES

16.1 The Municipal Finance Management Act provides that the Municipality may not guarantee any debt of any entity unless the entity is a Municipal entity under its sole ownership control. The debt must be reflected in the approved business plan of the entity. The guarantee must be authorised by the Municipality. This must be done in the same manner and subject to the same conditions applicable to any other borrowings. Neither the National nor Provincial Government may guarantee the debt of any Municipality.

## 17. APPROVAL OF LOANS BY THE MUNICIPALITY

17.1 Section 46 of the Municipal Finance Management Act stipulates that the Municipality may incur long-term debt only if a resolution of the Council, signed by the mayor, has approved the debt agreement and the Accounting Officer has signed the agreement or other document which acknowledges the debt. At least 21 days prior to the meeting of the Council at which approval for the debt is to be considered, the Municipality must make public an information statement setting out particulars of the proposed debt, including the amount of the proposed debt, the purposes for which the debt is to be incurred and particulars of any security to be provided. The Public, the National Treasury and Provincial Treasury must be invited to submit written comments or representations to the council in respect of the proposed debt.

17.2 A copy of the information statement submitted to Council at least 21 days prior to the meeting to approve the loan agreement must contain particulars of –

(a) The essential repayment terms, including the anticipated debt repayment schedule; and

(b) The anticipated total cost in connection with such debt over the repayment period.

## 18. PROVISION FOR REDEMPTION OF LOANS

18.1 Drakenstein Municipality may borrow from Institutions and set up sinking funds to facilitate loan repayments, especially when the repayment is to be met by a bullet payment on the maturity date of the loan. These sinking funds may also be invested directly with the Lender's Bank. The maturity date and accumulated value of such investment must coincide with the maturity date and amount of the intended loan that is to be repaid.

## 19. NON-REPAYMENT OR NON-SERVICING OF LOAN

19.1 Drakenstein Municipality must honour all its loan obligations timeously. Failure to effect prompt payment will adversely affect the raising of future loans at favourable costs of borrowing.

19.2 Failure to pay any loan instalment, even by one day, and even if only through administrative oversight, will have severe repercussions, and may jeopardise the Municipality's credit rating.

19.3 In addition to the timeous payment of the loans, the Municipality must adhere to the covenants stipulated in the loan agreements.

## 20. PROHIBITED BORROWING PRACTICES

20.1 Drakenstein Municipality shall not borrow for investment purposes, with the sole purpose of investing to earn a return. The cost of debt is almost always more expensive than the return that the Municipality can derive by investing in permitted investments.

20.2 Foreign Borrowing is permitted in terms of section 47 of the Municipal Finance Management Act, whereby the debt must be denominated in Rand and is not indexed to, or affected by, fluctuations in the value of the Rand against any foreign currency.

## 21. SHORT TITLE

21.1 This policy is called the Drakenstein Municipality Borrowing Policy.